ENERGY COMPASS®

Vol. 28, No. 37

September 15, 2017

NORTH AMERICA

Energy Industry Readies for Nafta Talks

Next week, negotiators from Canada, the US and Mexico will meet for the third time in six weeks for negotiations over the 23-year-old North American Free Trade Agreement (Nafta) (EC Jun.9'17). All sides agree the treaty could use an update. But the impetus for the renegotiations was US President Donald Trump's view that the deal is bad for the US — not consensus that the aging treaty could use a freshening-up. Trump's continued insistence that it may be best for Washington to simply walk away, and his administration's questioning of key issues supported by the energy industry, creates uncertainty for the estimated $140 billion North American energy market (EC Aug.25'17).

Industry in the three countries has been weighing in, urging negotiators to "do no harm" and warning of a return to tariffs and trade barriers, although trade along the US-Mexican border is more threatened by a reopened Nafta than that between the US and Canada. If Nafta were to collapse, Canada and the US — between which there is some $55 billion in energy-related trade — will essentially find themselves reverting back to a bilateral free trade agreement that predates Nafta. Trade with Mexico would be governed under World Trade Organization rules.

The biggest concern from the energy industry is the Trump administration's stance on the so-called Investor-State Dispute Settlement (ISDS), which gives companies access to an arbitration panel if country laws change in a way that threatens investments. Mexico and Canada support the mechanism, but Trump has been skeptical, and US opposition would be an about-face for Washington policy.

The current Nafta has such a mechanism, and industry worries about losing it. "Our view is that what's in place in the current Nafta, Chapter 11, is adequate," says Aaron Padilla of the American Petroleum Institute (API), the US oil and gas industry's biggest lobbying group. "There are some potential improvements that could be made, but the core of what we seek is there." In a joint position paper with the API, the Association of Mexican Hydrocarbon Companies and Canadian Association of Petroleum Producers have argued for rules that "provide for prompt, adequate and effective compensation" if investments are impacted by shifts in country policy.

The US has yet to propose text, sources say, and talk of Washington considering an "opt-in" caveat unsettles supporters. Without concrete text, it remains unclear how that would offer companies any more certainty than a treaty without ISDS. "US negotiators have floated this, but they haven't put it on the table," one Canadian source says. "We're not going to have a position on it until they actually table it." And a Nafta without ISDS is viewed as a threat to other trade arrangements (EC Feb.24'17). "It's going to set a precedent for the [other] free trade agreements," an industry source says.

Industry also worries about the potential for the Trump administration's "Buy American, Hire American" policy to be translated into trade talks as new standards for "rules of origin" in certain industries, investments or equipment. "Rules of origin is basically a local content policy, and we know the oil industry doesn't like high local content requirements," says Lisa Viscidi of the Inter-American Dialogue.

For all the industry wariness, the optimistic take is that the talks present an opportunity to address new issues. The API, for example, is also looking for changes to ease limits on non-Nafta diluent used to enable viscous heavy, sour crude from Canada to flow through cross-border pipelines. The industry would also like to claim a refund on imported crude oil duties if that oil is refined in the US and then sent on to Mexico or Canada — as it does with products sent to countries outside Nafta.

The energy sector has changed dramatically in Mexico, which in 2013 passed a far-reaching constitutional reform that ended long-standing state monopolies in hydrocarbons and power. There is talk of codifying the reform by eliminating exemptions in the original Nafta that accounted for its constitutional prohibition on private investment in its hydrocarbon sector. That's something the Mexican government believes it can leverage in energy-related talks, but it's not yet clear how it will do so. And industry's view of such a codification could change if, for example, new standards for local content are introduced.

Picking Up the Pace

Officially, negotiators are trying to finish talks by the end of this year — before 2018's electoral calendar in all three countries puts Nafta further in the political crosshairs. But the broad consensus from observers outside government is that the goal is essentially unattainable. Even US Commerce Secretary Wilbur Ross last week cautioned the most controversial issues still lie ahead.

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Moreover, observers in and out of government question whether US negotiators are truly empowered to make decisions when Trump's administration has not taken a position on major issues. A complicating factor for Mexico is that country's low confidence in Trump as a good-faith actor. That makes it politically difficult for Mexican officials to be seen as overly eager to meet US demands, particularly with next year's presidential election looming (EC Feb.3'17). Mexicans, in turn, fear Trump will lash out at them for political reasons of his own. "What worries us in Mexico is that he wants to hurt us," says Manuel Molano, assistant general director at Mexico City think tank Imco.

Canadian Prime Minister Justin Trudeau's government has its own political considerations, and is seeking to include climate protection, aboriginal rights and gender equality in the negotiations — unlikely to go down well with Trump's administration. A key bone of contention between Washington and Ottawa could stem from Canada's intention to implement a nationwide carbon tax, potentially leading Canada to eventually slap a duty on oil and gas imports from the US that are not subject to such taxes.

While the carbon tax is seen as a done deal, import duties look less likely. "This would certainly attract US attention, although markets are skeptical that this would actually happen — it could just be a case of the Liberal government pandering to left-wing voters [in the run-up to the next Canadian federal election]," says Christopher Sands of the Johns Hopkins School of Advanced International Studies in Washington. "I wouldn't say it's insincere, but I doubt there will be much support for it," he says. Ottawa is looking instead at other ways to protect the industry, the understanding being that if industry supports the tax, it will get reciprocal help from the government. ■

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